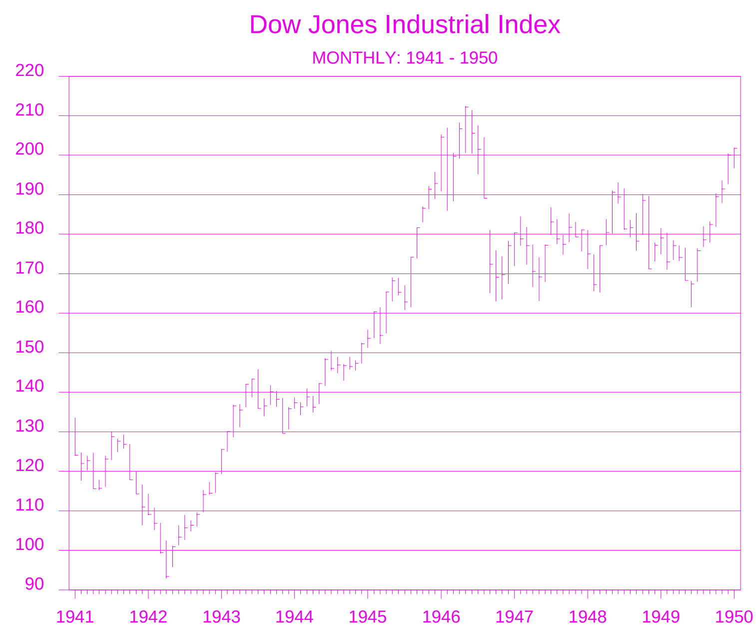
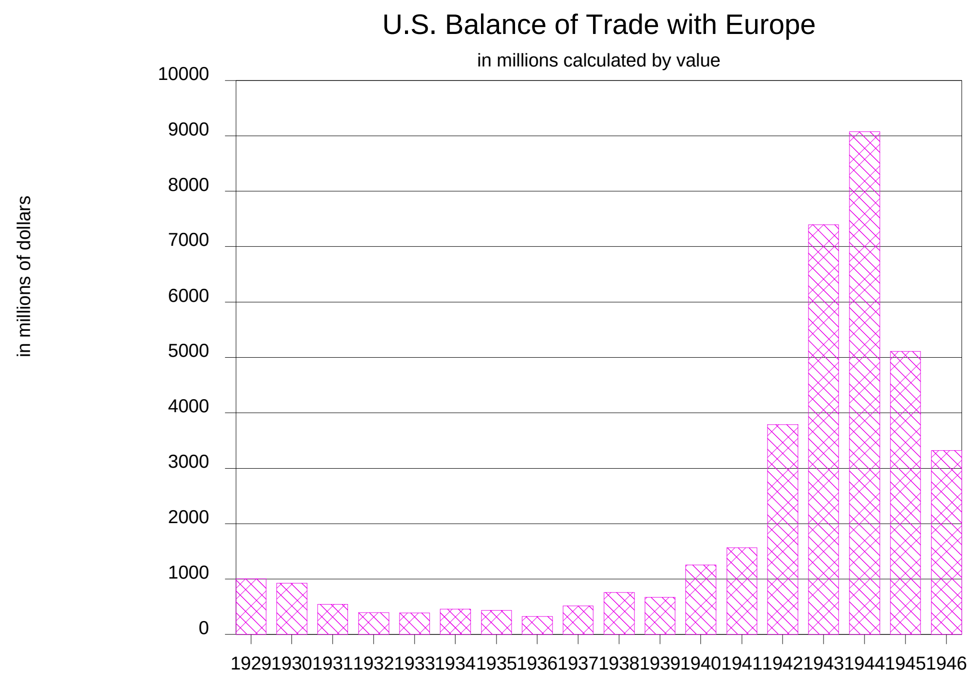
From the 1937 high in the Dow Jones Industrials, the market essentially traded sideways back and forth between the 160 level, eventually falling under the 1938 low moving into April 1942. Then the trade surplus began to widen in favour of the U.S. as Europe needed the production facilities from its industries. By the spring of 1946, the Dow Jones Industrials rallied from 93 to 212 throughout the course of World War II.



	Trade Surplus (Deficit)			
	U.S.	Europe	U.K.	France
1941	1,675	1,566	(649)	(9.16)
1942	5,247	3,789	(721)	3.71
1943	9,461	7,693	(994)	21.45
1944	10,233	9,364	(1,027)	15.79
1945	5,426	5,106	(654)	(45.63)
1946	4,767	3,318	(336)	(16.33)
1947	9,530	4,853	(597)	(17.38)

The above table of foreign trade illustrates how the world situation stood between 1941 and 1947. The first column represents the total world trade picture of the United States expressed in millions of dollars. The second column, U.S./Europe, is exclusively the trade between Europe and the U.S. in millions of dollars. Note that Europe was the largest trading partner. The United Kingdom (Britain) is expressed in millions of pounds and the French data is provided in billions of francs.

We can see clearly that the huge swing in the trade surplus for the United States as supported by the above table, provided two aspects to the U.S. economy and marketplace. First, the capital inflow sparked virtually a straight up move in the Dow Jones Industrials between 1942 and 1946. If you refer to the chart covering the years between 1941 and 1950, notice that the only pause in the trend came during the later part of 1943. Other than that five month correction, the trend was virtually straight up with only seven other months which even briefly penetrated below the previous month's low. When the market came to its abrupt high in 1946, the bottom was well established during the five month panic collapse in 1946 from the major high.



The second effect that this huge trade surplus in favour of the United States had upon the economy was reflected in the official gold reserves. It was America's industrial production through the innovation of the automobile and the airplane that provided goods for European consumption. For that productivity, Europe paid in terms of gold and in 1950 when all the dust had settled, the United States held 76% of the entire official world gold reserves. This factor would serve as the primary reason why the U.S. dollar would gain world dominance from 1950 onward.

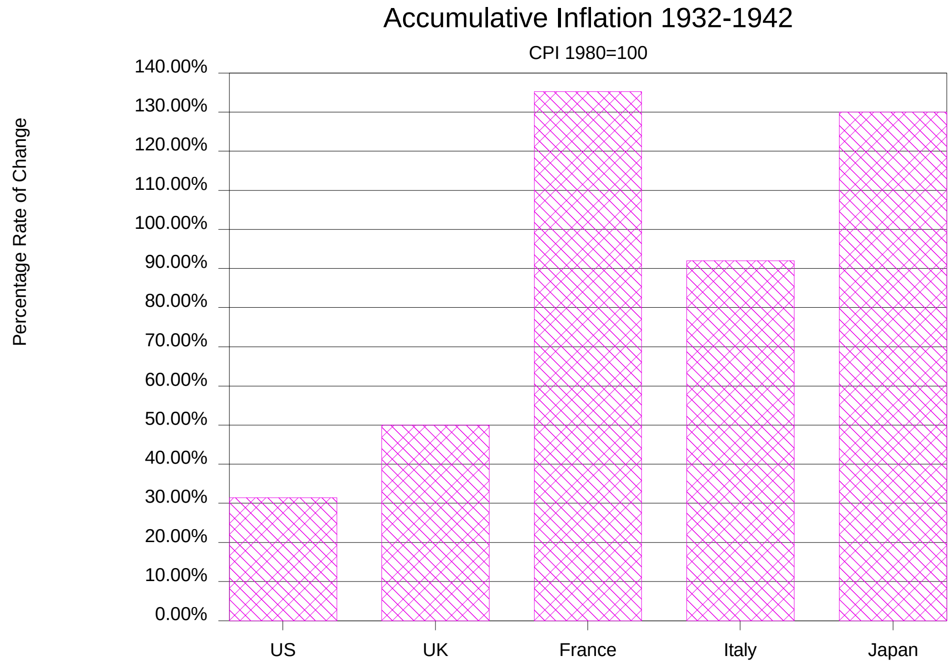
Again, immediately following the war, many commodities were in short supply and the reconstruction which was anticipated led to much immediate postwar speculation going into 1946. But this was nowhere as significant as that which followed World War I preceding the panic of 1920.

Following the early 1946 high, a recession period set in as trade declined and government spending for armaments decreased. The trade surplus expanded in the United States during 1947 but much of this was for raw materials and civilian goods. The stock market regained about 50% of its loss from the high in 1946. But the economy was shifting from war to peace and this took some readjusting on the part of industry.

There are several points which should be made in respect to the rally in the stock market between 1942 and 1946. We have read how during the rally of 1933-1937, the attitude toward the market was one of a hedge against inflation. It is important to our understanding of market behavior that we look at the inflationary aspects of the 1942-1946 period as well. The following table compares the Producer Price Indexes on an international basis. Roosevelt's currency inflation actually exported inflation to other nations, which prompted the battle of devaluation practices.

Producer Price Index 1932-1942

	1932	1942	% Chg
U.S.	12.5	19.0	+ 52%
U.K.	4.1	7.6	+ 85%
France	0.61	1.9	+ 211%



Italy	0.26	0.55-	+ 111%
Japan	0.10	0.23	+ 130%

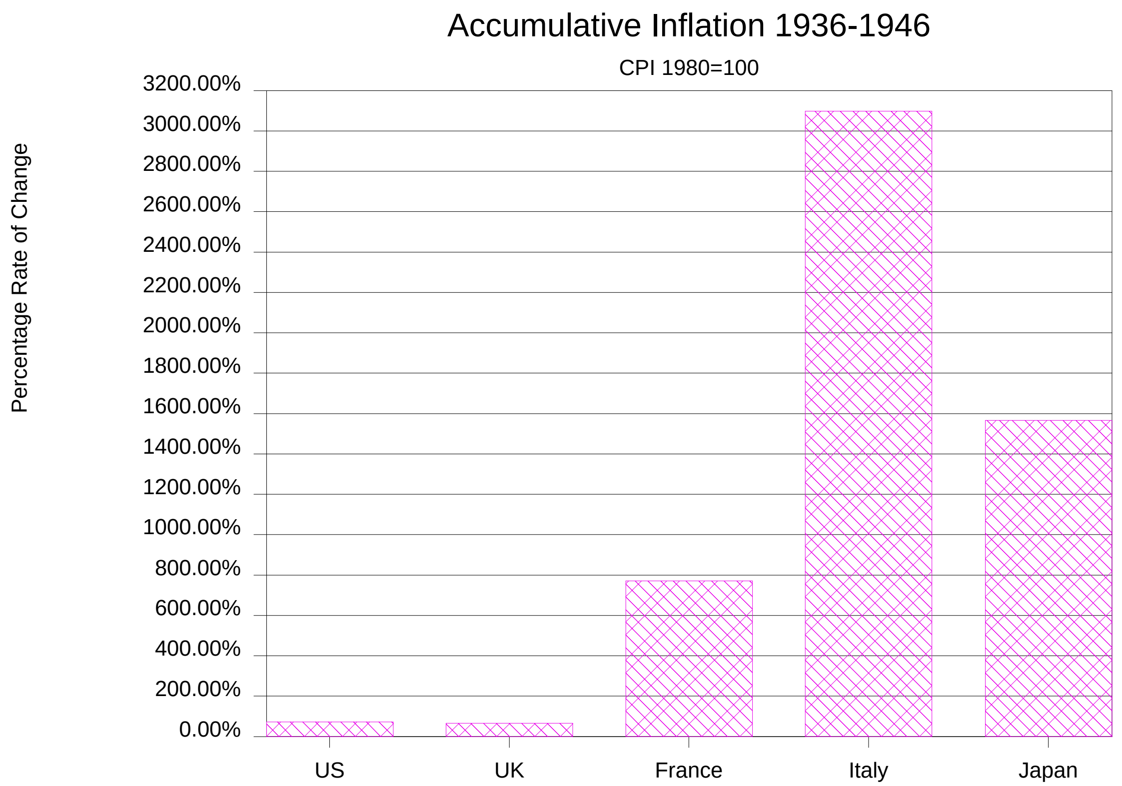
The above table illustrates that inflation was varied from one nation to another. But there is no question that the 1932-1942 period was one of inflationary trends. The curious factor is that although government spending continued between 1936 and 1942, the economy itself had entered a recession. Therefore, the concept that government could increase its spending to stimulate the economy did not unfold as some would like us to believe.

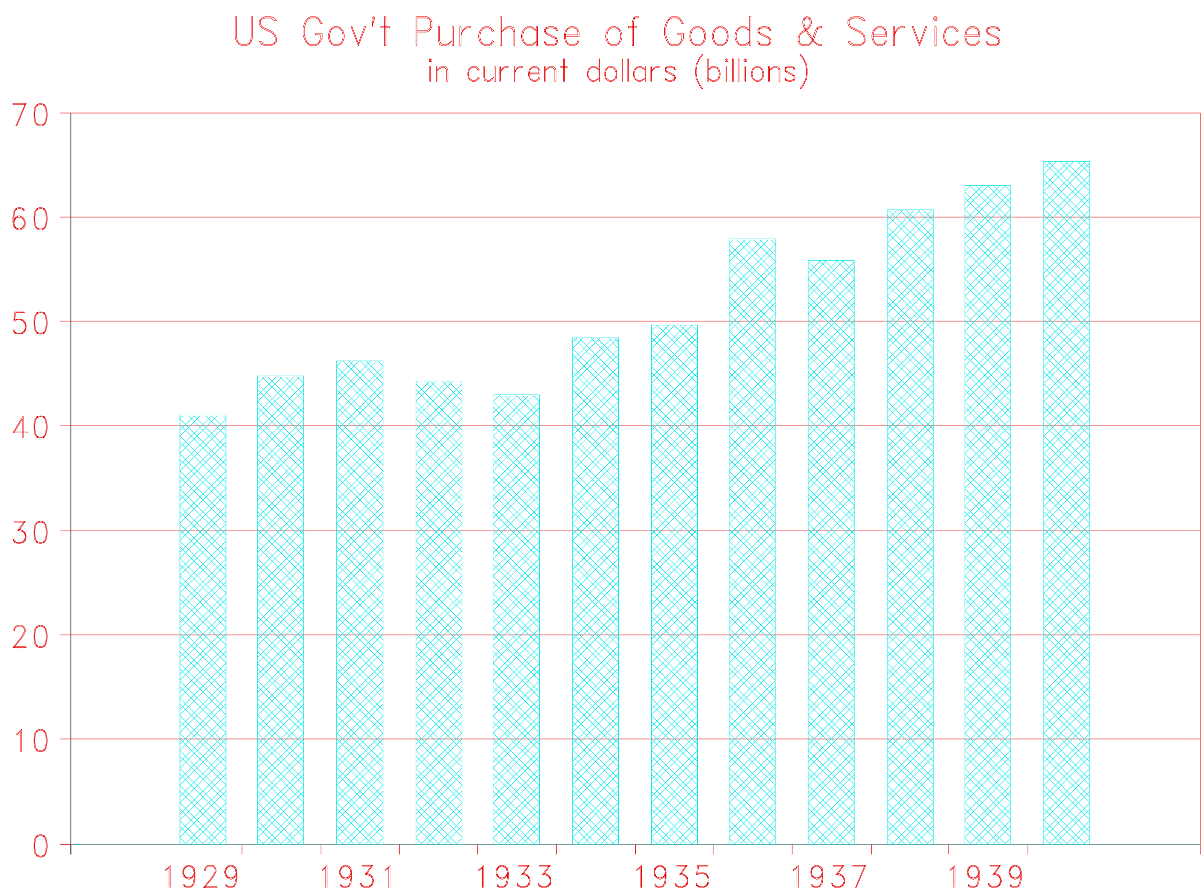
The economy finally improved in the United States in response to the huge increase in foreign buying due to the war as reviewed in the previous table on Trade Surplus from 1941-1947. The effects of World War II on the inflationary picture are quite clear. Between 1936 and 1946, inflation rose much greater than in the 1932-1942 period. The following table of Producer Price Indexes illustrates this quite bluntly.

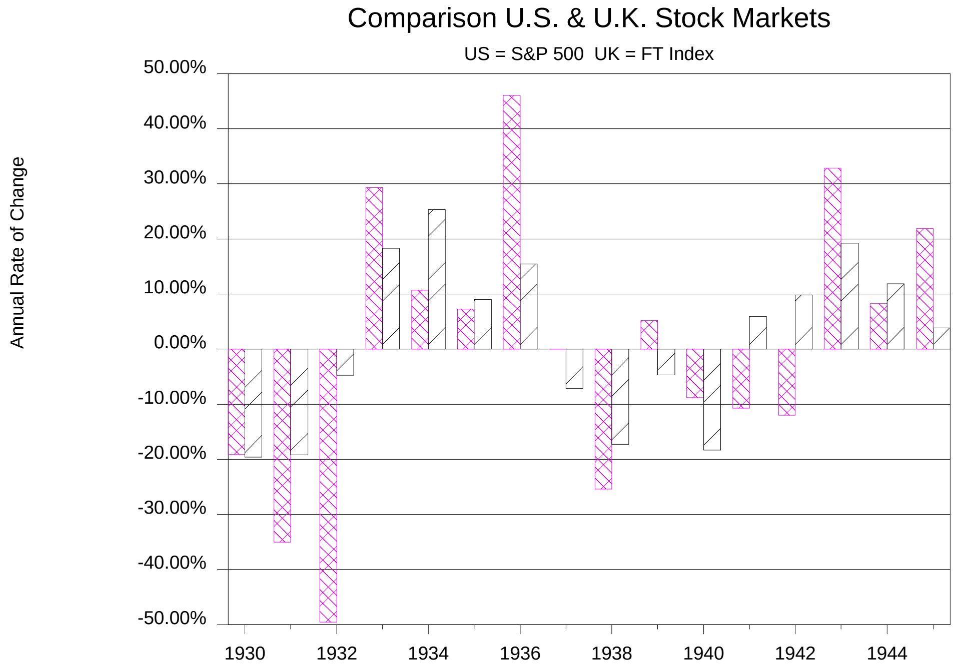
Producer Price Indexes 1936-1946

	1936	1946	%Chg
U.S.	15.5	23.2	49.6%
U.K.	4.6	9.2	100%
France	0.60	6.0	1,000%
Italy	0.29	10.4	3,486%
Japan	0.12	2.0	1,566%

Inflation in the United States was not that dramatically different in the 1936-1946 period compared to the 1932-1942 period. The prewar period posted a 52% inflation rate while during the war, when price controls and rationing were employed, inflation actually declined to 49.6%. Still this was a sizable gain in inflation for this war period. It did not hamper the stock market from rallying whatsoever. The European situation was much more different when we compare the previous inflation tables. In Britain, inflation rose from 85.3% in the prewar period to 100% during the 1936-1946 era. In France, inflation rose from 211% to 1,000%, while Italy bore perhaps the largest brunt of inflation, jumping from a prewar rate of 111% to 3,486% during the 1936-1946 period.


Accumulative Inflation 1936-1946
CPI 1980=100
Percentage Rate of Change
3200.00%
3000.00%
2800.00%
2600.00%
2400.00%
2200.00%
2000.00%
1800.00%
1600.00%
1400.00%
1200.00%
1000.00%
800.00%
600.00%
400.00%
200.00%
0.00%
US
UK
France
Italy
Japan


US Gov't Purchase of Goods & Services
in current dollars (billions)
70
60
50
40
30
20
10
0
1929
1931
1933
1935
1937
1939



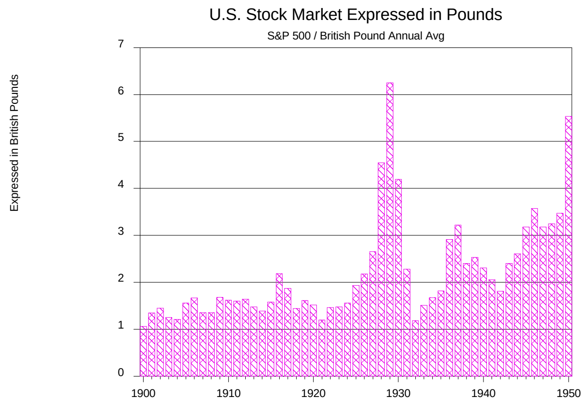
If we look at the stock markets in Britain and the United States, we can see clearly that it was the U.S. market which offered the hedge against worldwide inflation once again.

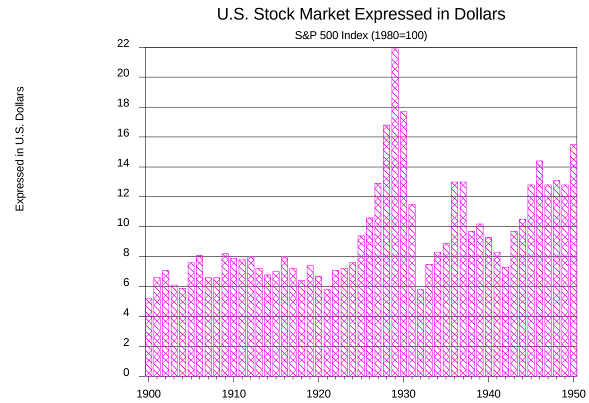
Industrial Stock Indexes

	1936	1946	%Chg	Adj. for Infl.
U.S. (Dow)	160.00	180 .00	12.5%	(-36.9%)
U.K.	11.2	11.9	6.25%	(-93.7%)
(Dow in terms of pounds)				
Pound Avg	4.971	4.03	(18.9%)	
Dow in terms of pound			31.4%	(-17.9%)

The above table introduces the concept of how the U.S. market appeared to the British investor seeking a hedge against inflation. Although the Dow Jones Industrials rose only 12.5% in the face of 49.4% domestic inflation, the sharp rise in the dollar against the pound, 18.9% with exchange controls, actually increased the value of the Dow by 31.4% in their eyes, ignoring the inflationary considerations. Taking into account the inflationary trends in the United States, the Dow Jones Industrials declined in terms of pounds by only 17.9% compared to the British stock market, which declined by 93.7% after adjusting for British inflation.

For some reason, the majority of analysts in the United States have lived in a fish bowl of isolation. They have formed their conclusions based upon domestic considerations. The rise in the stock market between 1942 and 1946 was not outstanding in terms of dollars versus inflation. It managed to exceed the 1936 high of 193 by reaching only 212 in 1946. Some would definitely point to this period as evidence that the stock market does not prosper during periods of inflation. But to the contrary, it at least rallied and moved to new highs. From an international perspective, the dollar was rising in international purchasing power. Even though U.S. domestic accumulative inflation was 49.4%, Its purchasing power against a basket of currencies, including the franc, lira, yen and the pound, increased





31.8%. Therefore, $100 in 1936 would have purchased nearly $132 in foreign goods during 1946. Therefore, let's create a basket basis 1949 and compare it to 1929.

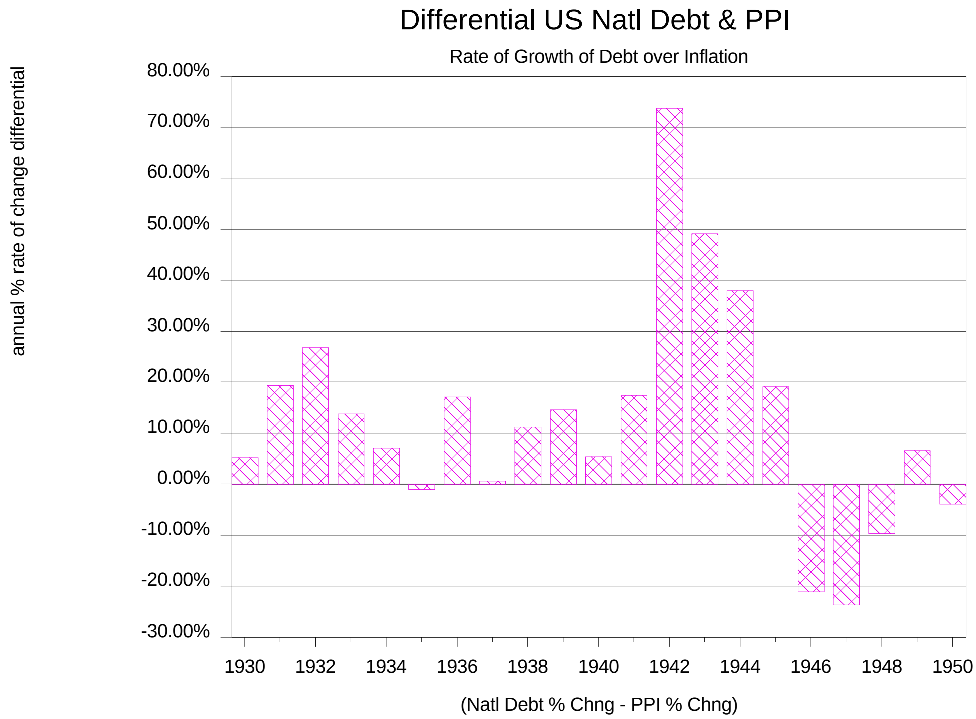
Dow Jones Industrials Expressed
in a Basket of Currencies

	1929	1949	% Change
Pound	$4.857	$3.680	(24.2%)
Franc	.039	.003	(92.3%)
Lira	.052	.001	(98.0%)
Yen	+ .460	.003	(99.3%)
Basket (X)	5.408	3.687	
(X+ 1/5) (Y)	1.280	.937	
(1/Y)= I	.78	1.06	
Dow Ind	386	212	
(Dow x I)	301	225	(25.2%)

The basket in the above table was created without weights. I obtained the sum of the four currencies and added 1 to represent the dollar and then divided by 5 which gave the figure "Y." I then divided 1 by "Y" to establish a unit of international value "I" which is easier on the eye to comprehend from the U.S. perspective. In 1929, that international unit of value was equal to 78 cents so to speak. In 1949, it was worth $1.06. Therefore, this illustrates the overall appreciation of the dollar itself during this 20 year period. Then taking this figure and simply multiplying it against the Dow, we obtain an adjustment in terms of international purchasing power. This exercise demonstrates that purchasing power between the international Dow was only 25.2% less than the 1929 high, whereas, in contrasting terms the Dow was still 45% below the 1929 high.

Much of the real inflation never hit home during the 1940s. This was largely due to the fact that a fair portion of the debt was resulting from foreign loans which again were being floated through U.S. bonds. The following table illustrates the impact of government spending and the lag in inflation on a percentage basis to the rise in the national debt.

	Fed Budget Surplus (-) ($mil)	Wholesale Price Ind (1967= 100)	National Debt ($bil)
1937	(2,777)	44.5	36.4
1938	(1,177)	40.5	37.2
1939	(3,862)	39.8	41.9
1940	(2,710)	40.5	45.0
	Fed Budget Surplus (-) ($mil)	Wholesale Price Ind (1967= 100)	National Debt ($bil)
1941	(4,778)	45.1	57.9



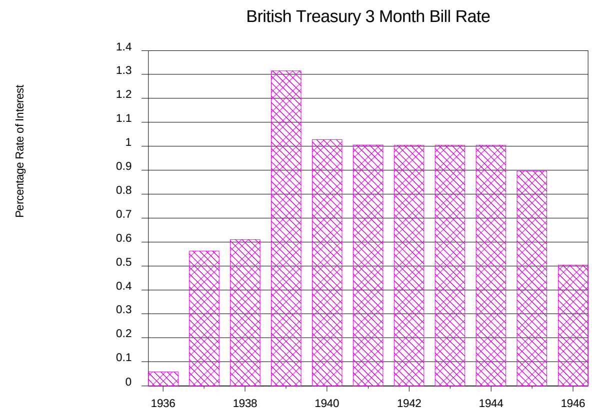
1942	(19,396)	50.9	108.2
1943	(53,812)	53.3	165.9
1944	(46,138)	53.6	239.6
1945	(45,022)	54.6	278.1
1946	(18,201)	62.3	259.1
1947	6,600	76.5	256.9
1948	8,864	82.8	252.8
1949	1,006	78.7	257.1
1950	(2,207)	81.8	256.7

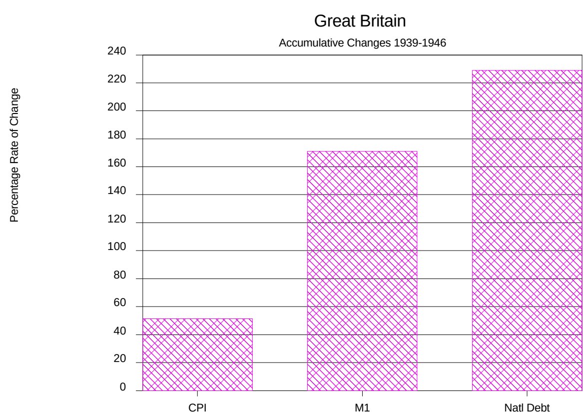
Upon Roosevelt's death in 1945, Truman immediately attempted to end the inflationary policies of his predecessor. This is evident by the sharp reduction in the fiscal deficit for 1946 and the immediate return to surplus during the years of 1947-1949. The national debt came to a screeching halt and did not exceed the 1946 high until the early 1950s.

Much of the inflation in the United States was highly controlled by Roosevelt. The army actually seized the gold mines and all production was under government management. Rationing and strict price controls sheltered much of the domestic economy from the real inflationary trends hidden in the national debt.

In the midst of all this chaos, the United Nations managed to put together an economic summit during July 1944, held at Bretton Woods, New Hampshire. It was at this conference that the theory of manipulating foreign exchange rates, such as those of the central banks back in 1925-1927 and the devaluation practices of Roosevelt, were attacked. Bretton Woods brought forth the establishment of the World Bank and the International Monetary Fund (IMF). Although the war was not yet over, the member nations sought to look forward to the economic problems which would face them once the war had come to an end.

The monetary system that was formulated at Bretton Woods was based upon a pledge from all member nations to keep their currency within a percentage point or to an agreed dollar value. The IMF was designed to provide moral suasion and credit to keep the system alive.

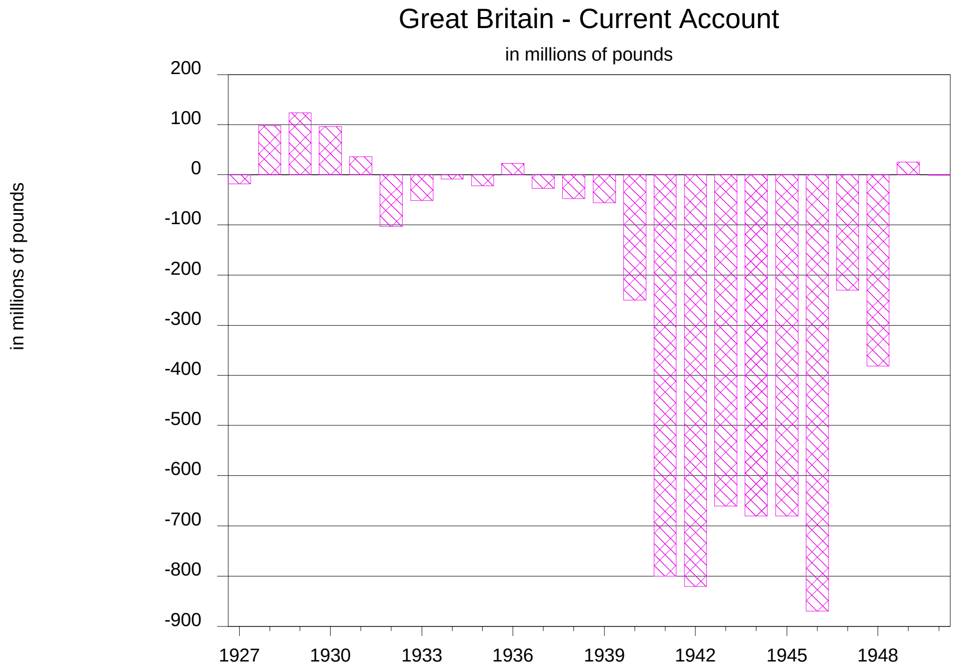




But the economic problems could not be swept away by Bretton Woods. In Britain, the national debt had risen from 7.2 billion pounds in 1939 to 23.7 billion pounds in 1946. where it was absolutely necessary, rationing and campaigning to promote lending to the government. Through these measures, excess capital was absorbed by government and not used by the private sector for speculation, or investment expansion. In one sense, it was like a communist state where most of the capital and profits are absorbed by government through strict controls which hold off inflation on domestic products at the very least.

Another step taken both in Britain and in the United States was the "official" management of interest rates. In Britain, the bank rate had jumped to 4% in 1939. But this was brought down to 2% and remained there during the war. The normal forces of supply and demand were simply not permitted to work. This is why interest rates did not rise in response to the huge borrowing on governmental levels in both Britain and the United States.

Had there not been a commitment on the part of the public to stand behind their respective governments, these practices would not have worked. It would be dangerous to assume that this could have been successful under peacetime situations. The public spirit was directly behind the war and sacrifices were given in full knowledge that when it was over, things would return to normal. Some argue that since it worked once, it would work now to solve our economic problems. But this is merely a communistic idea disguised among economic principles. People were deprived of their fruits from labour and to suggest that strict price controls, higher taxation, and huge government spending for social programs can be maintained indefinitely is pure madness. These are the grounds for revolution



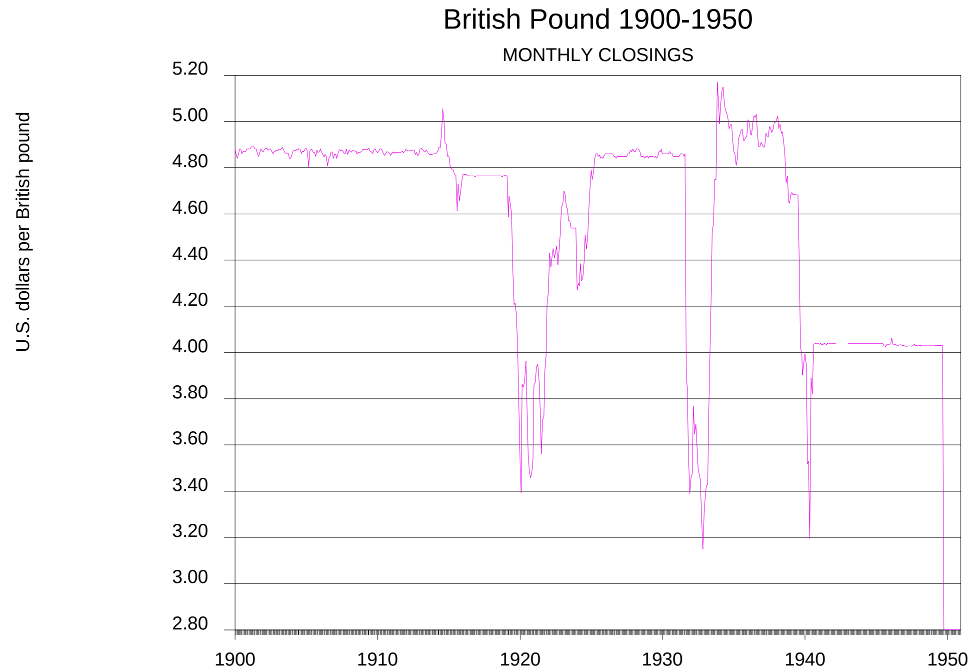
Raw Data Source: Economic Statistics

and indeed, they are some of the very reasons the colonists revolted against Britain back in 1776. Nonetheless, government did not relinquish all of its usurped power. Although Federal rent control was abolished after the war, some states such as New York did not. Eventually the State of New York dropped rent control, but the City of New York still maintains that power to this very day.

Early on in the War, drastic steps were taken on the part of Britain to help finance the huge expenditures. Britain "requisitioned" investments overseas, including the business operations of British insurance companies. Between 1940 and 1941, British investments in the United States were sold for 200 million pounds. Another 225 million pounds worth of investments were sold to Canada. In addition to these sales, Britain borrowed 425 million pounds from the Reconstruction Finance Corporation (RFC) in the U.S. which had originally been established by Hoover to support the banking industry. Despite all of this borrowing, the reserves of dollars and gold held by Britain in 1939, which amounted to 606 million pounds, declined to 75 million by the end of 1940.

Even after Bretton Woods the problems continued. After Roosevelt's death, Truman cancelled the Lend-Lease program. This magnanimous lending policy for Britain was explained to the American people by Roosevelt in simple terms. Basically, he said, if your neighbor's house is burning down, you should not bargain with him for a fee. You should put out the fire first. This was Roosevelt's clever way of lending vast sums to rebuild Britain. When Truman cancelled this blank check, the new government of Clement Attlee, which had promised sweeping social programs and reforms to the British population, was left with the balance of payments completely uncovered.

Attlee had not made the grave mistakes of Cunlife following World War I. Attlee's government at least viewed the pound as merely a unit of account, and he disassociated himself from the traditional pride of



Source: Wall Street Journal

the British to maintain the old $4.86 par value at all costs. The pound was still controlled for internal purposes, but its value on the international markets was now at risk. If it declined severely, the desperately needed imports for the reconstruction would rise in cost. This was the dilemma which faced Attlee in the first few months of his administration.

A delegation headed by the famous economist, John Maynard Keynes, left Britain for Washington. In September 1945, Keynes arrived in Washington with a huge shortfall in Britain's external account which had to be covered. Keynes had estimated that he needed to go home with 1.7 billion pounds just to break even by 1949. He was shooting for a loan of 1.5 billion pounds or roughly $6 billion. He asked that a large part of this sum be merely a grant and that the U.S. should not expect to be repaid. But "give'em hell Harry" was not in the mood for any free handouts. After three months of negotiation, Truman sent Keynes home with $3.75 billion, nearly half of what Keynes was looking for. But the entire amount was considered not a grant, but strictly a loan, carrying an interest factor of 2%. Canada added another 280 million pounds under similar terms.

Truman had attached to his loan two stipulations. The first was that the pound would be made completely convertible into foreign currency and exchange controls would be lifted within one year. Second, the proceeds from the loan could not be used to pay off Britain's wartime debts. This stipulation was attached based upon a theory of the "International Dream," as I have dubbed it. The concept was that if the United States loaned money for the reconstruction of Europe and Japan, that the reemergence of their economies would become viable markets for U.S. goods. This in turn would keep employment high in the United States and hopefully avoid the normal postwar depression phase. Truman was not the only man to conceive of this dream. It was essentially the goal following World War I with the huge influx of foreign loans and the goal of the Central Bankers back in 1925-1927.

Today we still chase the illusive international dream through the very structure of our new modern system for the international economy. Many believe that we have achieved it at brief moments in history. Ironically, man has scoured the earth in search of wealth and stability. He has assumed that everyone can prosper and live happily ever after simultaneously around the globe. He has been torn between the contrasting theories of communism and capitalism in his pursuit of his dream and often he has struck down the very fruits of freedom to achieve his goal. But every ideology from capitalism to socialism has its weakness.

There is one element which has been largely ignored in economics and in the analysis of the events of the Roaring 20s and the post-World War II era. The rise and fall of the world's monetary system was primarily caused by a tremendous experiment in internationalism which failed. That experiment has taken the form of manipulation in foreign exchange rates, interest rates and tariffs all in an effort to achieve equalized prosperity. Even now in this age, the Group of Five nations, led by the Secretary of the Treasury Baker, is making the very same mistakes as Benjamin Strong made in 1925.

In Herbert Hoover's memoirs on Page 85 of Chapter 12 on Foreign Loans, he begins by saying: "A part of the whole program of export expansion revolved around the provision of loans or credit to foreign enterprises and governments with which to buy American products." Indeed, this was the philosophy, the great international experiment which began in the aftermath of World War I and became the doctrine in the post-World War II era as well. The concept was simple. During the War, America was hard at work producing food which kept Europe alive. We produced many arms which Europe purchased. Americans were hard at work and Europeans paid in gold for the products. At the end of the War, the U.S. gold reserves had swelled to record levels. But American workers were unemployed since Europe no longer needed its military productive capabilities.

The great international experiment began at that time following World War I. One way to keep Americans working was to maintain the high levels of exportation. America had become addicted to it. Rather than focus upon the domestic revitalization, the focus was placed upon foreign exports. The concept of lending money to Europe with which they would then in turn buy American goods sounded very nice. It would raise the levels of employment, so the administrators believed.

However, Hoover was very astute and in his memoirs he continued on the subject as follows:

"In 1920 and 1921 the foreign governments and business were slow to realize that our era of taxpayers' largess was over; but by 1922 they came to understand it, and the whole problem took another complexion. A boom began in foreign loans with the offer by foreign countries of extravagant interest to private lenders, from 5 to 8 per cent per annum.

"These loans soon began to raise disturbing questions as to their security, their reproductive character, and the methods of promotion. To serve any good purpose, such loans had to be adequately secured and should increase the productivity of the country of their destination. Out of such increases alone could they be repaid. Loans used for military purposes, for balancing budgets, and for nonproductive purposes generally would be disastrous."

Hoover's comments offer some keen words of wisdom. If foreign loans were used for balancing budgets forced into deficit by social programs or military expenditures, there would be little hope of expecting repayment.

In order for those foreign loans to be loans which would have been repaid, they must produce income. That income, in turn, must come from another foreign nation. Let us simplify the situation by reducing the world down to three people. The first represents Europe, the second the United States, and the third Asia. Let us now introduce the element of money. There are only 12 ounces of gold in the world evenly distributed, which means that each has 4 ounces. Asia and Europe go to war but the U.S. produces all the supplies for Europe. Europe pays the U.S. 4 ounces of gold and now has no gold left. The war is over and now the U.S. has 8 ounces. It lends 4 back to Europe so that Europe will spend that on U.S. goods. So for a while this goes on and the U.S. now has 6 ounces plus a note from Europe that it owes it 4 ounces. The only way Europe can repay the 4 ounces is by selling goods to the U.S. for which it will be paid in gold. If that takes place, then the U.S. will decline in its exports and cries for protection from foreign imports will be heard from its people.

Therefore, the great international experiment failed. The United States could not expect to rebuild the world while expanding its own. When Europe essentially defaulted along with South America on its loans from the United States, capital losses were suffered both on a Federal level as well as on a private individual level. Thus the Great Depression in part was caused by much of the defaults of the time. Studies clearly illustrated that when South America defaulted on their bond issues, much of that was held by private investors and not banks. They could not write off losses against reserves. The losses were real and to the point. Thus, these events struck hard at the very spirit of the population. Those who had not speculated in stock yet believed the advertising that stated bonds were the "safe" investment, may have survived the crash of the stock market but not the crash of the bond market. Those who had tucked their capital away in real estate were wiped out by the lack of liquidity caused by the domino effect from the stocks and bonds. The great international experiment to lend money to the world in an effort to rebuild their economies as a viable market for U.S. exports backfired and created the Great Depression.

Today we still seek to achieve this "International Dream." Following World War II, the very same philosophy took hold and the United States once again lent its capital to rebuild Japan and Europe. In more recent times, Europe has joined in this pursuit and lent much of its capital to foreign nations in the third world. Now they too suffer at the hands of other nations.

As we look at the remaining period following World War II, we will see that Roosevelt's abandoning of the gold convertibility in 1934 had a very profound impact upon the future of the world. In the United States, the lack of convertibility of gold for domestic U.S. citizens acted as a mask hiding the true economic shift of wealth and the cost of the 'International Dream" to the United States. Under a full gold standard, if government spending got out of hand, the people would sense this and if they lost confidence in the government's ability to meet its obligations due to dwindling gold reserves, panic would normally strike.

Under Roosevelt's limited gold standard, he successfully eliminated the domestic gold panics by simply outlawing gold ownership. Thus, government spending could continue and over the long-term inflation of goods resulted. Thus, private investments would rise sharply in varying cycles of popularity. Panic dumping of dollars and buying of goods, or a commodity or at times stocks replaced the old panic into gold. As long as government did not back its currency with condominiums or shares of G.M. or bushels of wheat, such panics in the post-World War II era did not create a run on the Treasury. Therefore, Roosevelt's limited gold standard did manage to eliminate the crisis in currency which had existed since the days of the revolution.

Those who criticize the gold standard will always point out this drastic departure. But what they fail to realize is that although the Roosevelt limited gold standard may have eliminated the domestic gold panics, it merely allowed government to spend huge sums of money it never had without any immediate consequence on the domestic political scene. As a result, we will see how various investments as well as currencies and even bonds at various times have replaced gold in so far as the medium into which panic is focused. The elimination of gold convertibility has not eliminated man's emotional tendency for financial panic.

In 1950, the United States held 76% of the entire official world gold reserves. When President Nixon was forced to abandon the gold convertibility of the dollar for foreign nations, the U.S. reserves stood at 23%. Roosevelt's limited gold system may have sheltered the domestic economy for a longer period of time, but that was not achieved without a cost. Gold panics between nations still took place. As the United States lent vast sums of dollars under the theory of the "International Dream," there were no stipulations that those dollars could not be handed back for gold bullion at the Treasury. In the mid-1960s, the press began to talk about France's apparent distrust of the dollar and desire for gold. France was the largest withdrawer of gold from the U.S. Treasury during that period. The lack of confidence by foreign nations led to massive withdrawals until Nixon was forced to close the gold window to allow the dollar to "seek its own level."

By 1971, most Americans had no concept of what those words even meant. To them, a dollar bill still looked the same. Most were very young when Roosevelt had taken office and few were alive who would have remembered the terrible consequences of wildly fluctuating foreign exchange. An old problem had reemerged in a generation that had grown up completely oblivious to the idea that money was in reality another commodity. Its price had merely been fixed for 35 years in the same fashion that OPEC attempted to fix the price of oil. Eventually no matter who it is, the free market forces will emerge victorious.

It is ironic that some who have a long list of fancy degrees in economics have done their best to contrive a means around reality. If we reduce the "International Dream" down to a simple example, we can see through all its fallacies. Let us take seven people and let each represent a nation or group of nations (Britain, Canada, France, Germany, Japan, U.S. and Mexico). If we assume that each person has $10 and one person decides that he wants to produce something that the others will buy so that he can make a profit, then if all the money in the world only amounts to $70, obviously that is the maximum that any one person could have. So let us say that this person is Japan and he has invented a car. All the other people would like to buy one so they do and pay Japan $1 each. So Japan has $16 and the remaining people in the world have $9 each. In order for Japan to have earned that profit, the other nations had incurred a "trade deficit." You can see clearly now that it is impossible for all seven people to earn a profit. Not all nations can have a trade surplus simultaneously.

The trade game can become more complicated when the players are no longer tied to a fixed amount of money. When they all agree that they will no longer use dollars but each will now issue its own currency, we introduce the element of inflation. But if one nation, for example, Mexico, has no trade surplus and instead it continues to print pesos, the others automatically begin to discount Mexico's currency. They lose their confidence in Mexico's ability to remain as a player in the game. When there is no tangible item being used for money and all that is used is merely paper currency, then the value of those currencies swing back and forth on a factor of confidence. This we know is true today and I have illustrated how the currencies have swung greatly between 1920 and 1924 based upon everything from war to new political elections and fears of political actions.

Therefore, the concept that all nations can prosper simultaneously is absolutely absurd. Yet at the same time, a trade surplus is the goal of every nation. But when one nation lends to another and that nation refuses to repay, the net effect is quite simple. In the case of the United States, it had acquired 76% of the world's official gold reserves by producing food and arms for

Europe. If the U.S. lent $100 to Europe, $100 to Japan and $100 to the third world, and those nations indeed bought U.S. goods and kept Americans working, then at 8% interest, those nations will double their debt to the U.S. in just 9 years. Therefore, unless they swing the trade against the United States in equal proportion to the debt, they will never be able to repay those loans. If they are successful in obtaining a trade surplus, then the U.S. will have a trade deficit and the objective of employment for the U.S. is lost in the end. If they are not successful in turning the tide of trade and continue to maintain a trade deficit or a surplus which is not sufficient to repay the interest, then they will eventually default. In that case, all the labour of the U.S., which created the goods sold to the other nations through credit, go unpaid. If there is one science that is not based upon theory but reality, it is mathematics. 1 + 1 will always equal 2, no matter how hard a politician or economist may try to turn it into 3.

In the reality of international default, the world is faced with several factors. If a nation cannot meet its obligations and the creditor nation merely lends additional capital so that the debtor can then take the new funds and pay the interest on the old debt, the bottom line effect is to merely postpone the eventual default. The public who has been paid for its labour has invested in various mediums including its homes. On the surface the labourer believes that he has profited as his house has risen substantially in value but in reality if he sells that house, he will find that he cannot buy a new home of similar quality and size. His savings depreciate in value according to the level of inflation that takes place. If goods are merely produced and given away without true tangible repayment, the deficit is made up by government spending and accumulated debt. In turn, government raises taxes and the labourer ends up repaying what he had received for his own labour, which government chose to give away. Daniel Webster once said: "Of all the contrivances for cheating the labouring classes of mankind, none has been more effective than that which deludes them with paper money."

One can make two cases of this situation. The argument that money should be something tangible like gold has carried a lot of weight in some circles. But the rigidness of such a system does not allow for imbalances to go on for extended periods of time. The books must be balanced. Thus, it may have a tendency to promote more panics or crises as long as fiscal irresponsibility on the part of government is a way of life. Waves of inflation under the gold standard are directed by new discoveries of gold. Thus the inflationary wave in the 1850s caused by the California discoveries and the Spanish conquest of the Americas in the 1500s are classic examples. At times, the rigidness of the gold standard promoted war for the object of profit, or in modern terms increased money supply. This has been a favorite motive long before the days of Alexander the

Great and, in fact, was a primary reason for the American Revolution:

"No taxation without representation!"

Those who argue that a gold standard would force responsibility upon government to contain its spending forget that governments were irresponsible under the gold standard as well. Adam Smith wrote the modern textbook of all time on the subject of economics. In 1776, he published his "Wealth of Nations" in which he stated the following:

"It is the highest impertinence of kings and ministers to pretend to watch over the economy of private people and to restrain their expense, either by sumptuary laws, or by prohibiting the importation of foreign luxuries. They are themselves always, and without any exception, the greatest spendthrifts in the society. Let them look well after their own expense, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will."

Those who argue that the gold standard is a barbarous relic of the medieval days for maintaining reserves, do so only to promote the system of blank checks. Under the paper system the panics have not been eliminated. The frequency of the panics seems to be returning to the pre-1934 days. Under the limited gold standard between 1934-1971, those panics were not as noticeable nor as drastic. Most crisis situations took place between the treasury of one nation versus another and the domestic economies were spared the knowledge and the fears.

From the government's perspective, the advantage of the total paper standard lies in the fact that government does not have to wait for new gold mines to be discovered in order to increase the money supply. All they need do is pass an act of Congress to extend its debt limit so it can increase the money supply. Eventually the laws of mathematics and the natural forces of human nature itself will undermine the confidence in the paper system and it will collapse just as easily as it did under the gold standard. The swings in foreign exchange during the period we have reviewed in this study closely paralleled the swings in the investment world as confidence compelled investors to flee from one currency to another, thereby affecting the various stock markets around the world.

The Great Depression was not invented by the stock market. It was created by the forces of unsound international finance and sumptuary laws imposed upon the subjects of various nations both in the United States and in Europe. There is no doubt that the fate of the stock market in the future will be largely dictated by the swings in confidence within the international monetary system. Unaware domestic investors and analysts may attribute the current rise in the market going into the summer of 1986 to expectations of lower interest rates, but with hindsight this will prove in the end to be a totally erroneous explanation of what took place in the late 1980s.

In conclusion, the fundamental explanations of the ups and downs of the stock market and the world economy cannot be simply drawn between an inference with interest rate actions or with corporate earnings. The impact of public confidence is by far the most profound influence in both the investment world as well as the world economy. Capital flowing back and forth between nations affords the closest relationship with the movement within the stock market and this perhaps can be most readily seen through the movement of foreign exchange markets as well. The issues are never purely domestic. No matter what market one may look at in whatever nation you may reside, the international influences will always be a subtle guiding force behind the more illuminated domestic issues of the day.

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